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Simultaneous Attachment of Liens on After-acquired Property

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A favorite puzzle of debtor-creditor professors is determining the priority of liens that attach to the same collateral at exactly the same point in time. Simultaneous liens commonly arise when all the requisite steps for lien creation have been taken, except for the debtor's acquisition of the collateral.[1]

Simultaneous attachment of liens depends upon the susceptibility of the debtor's "after-acquired property" ("AAP") to the creditor's lien.[2] Article 9 of the Uniform Commercial Code ("UCC"),[3] for example, permits security agreements to be secured by AAP.[4] Similarly, liens on AAP can be effectively created in a real estate mortgage agreement.[5] In addition, docketed judgments become liens on any

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1 Not all simultaneous lien cases arise as the result of after-acquired property rights connected with the liens. For example, in Southern Rock, Inc. v. B & B Auto Supply, 711 F.2d 683 (5th Cir. 1983), the Article 9 secured creditor and the Internal Revenue Service each filed their respective filings before office hours. The clerk apparently treated all the overnight submissions as simultaneously filed.

2 For a general discussion of AAP under Article 9 of the UCC, see Coogan, Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien," 72 Harv. L. Rev. 838, 851–52 (1959); Gilmore, The Purchase Money Priority, 76 Harv. L. Rev. 1333 (1963); Hogan, Future Goods, Floating Liens, and Foolish Creditors, 17 Stan. L. Rev. 822 (1965); Skilton, Security Interests in After-Acquired Property Under the Uniform Commercial Code, 1974 Wis. L. Rev. 925. For a discussion of AAP interests in fixtures, see 2 A. Squillante & J. Fonseca, The Law of Modern Commercial Practices § 11:56 (rev. ed. 1981); Carlson, Fixture Priorities, 4 Cardozo L. Rev. 381, 386–88 (1983). The relationship between AAP interests in chattel paper and voidable preferences under the Bankruptcy Act of 1898 is dealt with in Professor Countryman's text on Commercial Law. V. Countryman, A. Kaufman & Z. Wiseman, Commercial Law Cases and Materials 287–89 (2d ed. 1982). For a discussion of security interests and judicial liens on AAP, see Carlson & Shupack, Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code: Part I, 5 Cardozo L. Rev. 287, 343–46 (1984). For a discussion of simultaneous mechanics' liens and mortgages, see Note, Commercial Law—Materialmen's Liens in North Carolina: The Problem of the Overeager Purchaser, 61 N.C.L. Rev. 926 (1983).

3 Unless otherwise indicated, all citations to the UCC are to the 1978 version.

4 U.C.C. § 9-204(1). This section reads: "Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." Id.

Subsection (2) imposes severe restrictions on after-acquired security interests in consumer goods. Id. § 9-204(2).

5 M. Friedman, Contracts and Conveyances of Real Property 691–93 (4th ed. 1984); 3 G.

land the debtor may acquire within the county of docketing.[6]

The principle that has been universally applied in these circumstances is "*qui non habet, ille non dat*"—the debtor can transfer only the property he has.[7] If a lien is an encumbrance on the debtor's property, the lien obviously cannot exist until the debtor has property. Hence, the lien exists only from the time the property is acquired. At that point, security agreements, mortgages, and docketed judgments instantly cause the creation of simultaneous liens.[8]

Numerous statutes and court opinions have dealt with the question of priority of simultaneous liens *inter se*. In the absence of specific statutory guidance, courts have developed an amazing variety of solutions. What none of the literature does—and what I intend to do here—is to distinguish between lien priority and the rights of buyers at foreclosure sales. The two issues are drastically different, and yet courts and commentators have assumed they are the same.[9] It will be analytically useful if we separate these intertwining strands that run through the various priority rules for simultaneously created liens.

In Part I, I will set forth some basic definitions of liens and foreclosure, so that we can distinguish clearly between lien priorities and the rights of buyers at enforcement sales. In Part II, I will describe the various solutions courts and statutes have reached to determine lien priorities and buyer's title. These solutions will be placed in one of five organizing categories. It will be seen that most of the existing discussion fails to distinguish between lien priority *inter se* and title of buyers at enforcement sales. Finally, in Part III, I will try to identify the combination of policies that minimizes the cost of enforcing debts. The best solution, in my opinion, deemphasizes the importance of lien

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Glenn, Mortgages 1641–60 (1943); G. Osborne, Handbook on the Law of Mortgages 60–81 (2d ed. 1970).

[6] For example, N.Y. Civ. Prac. L. § 5203(a) (McKinney 1978) applies to after-acquired property. See Hohenrath v. Wallach, 37 A.D.2d 248, 250, 323 N.Y.S.2d 560, 562, appeal dismissed, 30 N.Y.2d 674, 282 N.E.2d 891, 332 N.Y.S.2d 106; see also Minn. Stat. Ann. § 548.09(1) (West 1983) ("[f]rom the time of such docketing the judgment shall be a lien . . . upon all real property in the county then or thereafter owned by the judgment debtor"). For states that do not allow judgment liens to attach to after-acquired property, see infra note 46.

[7] For the history of this phrase, see 1 G. Gilmore, Security Interests in Personal Property § 7.10, at 228–29 (1965).

[8] [A] judgment cannot attach as a lien against after-acquired real property until the property is acquired by the judgment debtor. This being so, it of course follows that, where judgments against the same judgment debtor are obtained at different times in favor of different persons, such judgments all become liens at the same instant upon real property thereafter acquired by him.

Zink v. James River Nat'l Bank, 58 N.D. 1, 5, 224 N.W. 901, 903 (1929).

[9] Professor Riesenfeld shows an appreciation for this distinction in his casebook on debtor-creditor law, but he does not fully elaborate on its significance. See S. Riesenfeld, Creditors' Remedies and Debtors' Rights 124–25 (3d ed. 1979).

priority as such (especially with regard to nonconsensual liens), and instead emphasizes broad foreclosure powers in enforcement sales.

I. LIEN PRIORITIES

The Coase theorum tells us that, absent transaction costs, strategic behavior, and income effects, efficiency is unaffected by the assignment of property rights.[10] Thus, the choice between various simultaneous lien priorities does not affect societal wealth unless they generate such costs. Priority for a lien created by consent may therefore have an important efficiency consequence. If we have a regime where complete or partial loss of priority is foreseeable, it will result in higher perceived risk and higher interest rates charged by secured creditors lending today.[11] Because interest is a marginal cost of production, the higher aggregate interest caused by the increase in risk creates a deadweight loss of wealth to society.[12] For example, changing the law to eliminate AAP rights would cause secured lenders to raise their interest rates because they would be lending against a smaller pool of collateral over time.[13] This increase, however, must be balanced against the lower interest charged by general creditors who are now lending against a greater pool of debtor's collateral. Whatever result a comparison would produce,[14] the efficiency point can only be made for *consensual* liens. If the rules of foreclosure[15] are broad enough, lien priorities in the case of simultaneous *nonconsensual* liens will have no impact on the general credit market.[16]

To see why this is so, it is necessary to say a few words about liens and priority. The discussion that follows is abstracted from numerous highly contradictory lien enforcement regimes. Almost nothing will be said that is not frequently contradicted in some statutory

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10 Coase, The Problem of Social Cost, 3 J.L. & Econ. 1 (1960).

11 The loss of priority in the case of simultaneous liens has the same effect on price that the loss of priority has in any context, although the loss to an *equal* lienor may only be partial. Carlson, A Theory of Contractual Lien and Debt Subordination, 38 Vand. L. Rev. (forthcoming). The leading account of the economic justifications for "first-in-time" priorities is Jackson & Kronman, Secured Financing and Priorities Among Creditors, 88 Yale L.J. 1143, 1161-64 (1979).

12 Carlson & Shupack, supra note 2, at 306 n.82; Weston, Some Economic Fundamentals for an Analysis of Bankruptcy, Law & Contemp. Probs., Autumn 1977, at 47, 49.

13 It would also generate huge paperwork costs if the parties had to execute a new security agreement each time the debtor acquired new property. Jackson & Kronman, supra note 11, at 1167.

14 Professors Jackson and Kronman argue that, because of transaction costs, these effects do not exactly offset one another. Id., at 1166.

15 See infra note 19. For the origin and history of foreclosure, see 2 G. Gilmore, supra note 7, § 43.2; 1 G. Glenn, supra note 5, §§ 57-58.1.

16 See infra text accompanying notes 100-16.

system. I will attempt to alert the reader to these exceptions in the footnotes.

A. *Foreclosure*

A lien is a creditor's interest in property.[17] When it becomes presently possessory, the lienor's rights are limited to sale in order to raise cash proceeds by which the lienor's claim may be paid.[18] In order to raise cash for this purpose, the lienor must have something to sell. What he sells is immunity from claims to superior title—foreclosure. Although rarely articulated, these foreclosures can be reduced to two logical minimums.[19] First, the buyer at a foreclosure sale must be immune from claims by the debtor. No buyer would bid for land that the debtor could simply take back.

The second foreclosure that is minimally required is that the buyer must take free of the enforcing lien.[20] If this were not true, no buyer would ever bid for land, since the lien creditor could simply execute a second time on the very land sold in the first place.

These are the logically minimum foreclosures that must occur. When they exist, buyers have something worth buying. Of course, it follows that buyers will pay more as the quality of their title improves.[21] Where perfect title can be offered, buyers will pay up to the market value of the collateral, if they have to.

One common expansion beyond the minimum foreclosure is the idea that all transfers by the debtor, made after the enforcing creditor's lien has attached, are foreclosed. This expansion is achieved by providing that a sheriff's deed or its equivalent conveys whatever the

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[17] For a case that misses even this simple point, see Independent School Dist. v. Werner, 43 Iowa 643 (1876). In *Werner*, the judgment debtor removed a fixture after the lien attached, but before the execution sale. The court determined that the act was not wrongful to the lienor because a lien is not a property interest in land, and only the sheriff's deed creates a transfer of the debtor's property. Id. This holding is dubious: the lien should have attached to the fixture and probably should have survived severance of the fixture. See Carlson & Shupack, Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code: Part II—Creditor Representatives, Bank Receivers, Fixtures, Crops, and Accessions, 5 Cardozo L. Rev. 823, 836 (1984).

[18] In some systems strict foreclosure is possible. See U.C.C. § 9-503; Sears, Roebuck & Co. v. Camp, 124 N.J. Eq. 403, 409–12, 1 A.2d 425, 428–29 (1938).

[19] The following theory of foreclosure was first presented in Carlson, Death and Subordination Under Article 9 of the Uniform Commercial Code: Senior Buyers and Senior Lien Creditors, 5 Cardozo L. Rev. 547, 565–71 (1984).

[20] See Keefe v. Cropper, 196 Iowa 1179, 1182, 194 N.W. 305, 306–07 (1923).

[21] See Maryland Nat'l Bank v. Porter-Way Harvester Mfg., 300 A.2d 8, 12 (Del. 1972).

debtor had at the moment the creditor's lien was created.[22] Among the useful effects of such an extension is that the debtor loses the ability to defeat the lien by making subsequent transfers.

Another expansion is the foreclosure of property interests already in existence when the enforcing creditor's lien attached to the debtor's own interest in the collateral. For example, a second security interest could attach to collateral that is already encumbered by an earlier security interest. If the earlier security interest is unperfected, it will not survive the enforcement sale of the senior secured party who was second in time. Although this result is often summarized by stating that the earlier security interest foreclosed because it was "junior,"[23] it is conceptually different from the foreclosure of a subsequently created junior interest. This latter type of junior security interest is foreclosed because the sheriff's deed conveys whatever the debtor had at the time the enforcing lien attached.[24]

Foreclosure of earlier unperfected interests creates an incentive to perfect. But foreclosures of other earlier interests occur for different reasons, primarily to make the enforcement sale more effective in raising cash. For example, in rem sales in admiralty destroy all outstanding interests in vessels and other maritime property.[25] Buyers at such sales are apt to pay full price for the vessel. They need not inves-

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22 E.g., Ariz. Rev. Stat. Ann. § 12-1625 (1982) (certificate of sale conveys "all the right which the debtor had in the property on the day the levy was made").

Courts and legislators occasionally miss the point. For example, in Norman v. Dougan, 201 Iowa 923, 208 N.W. 366 (1926), the court thought that the buyer at an execution sale "[took] the same title as though he were a purchaser at the same date from the judgment-debtor himself." Id. at 926, 208 N.W. at 368. The crucial question is what "same date" the court had in mind. Unfortunately, the court meant the date of the sheriff's deed. If taken seriously, liens in Iowa can be defeated by eleventh-hour conveyances. A better formulation is that the buyer takes as if the debtor made a voluntary conveyance at the time the lien arose.

The Hawaii legislature has drafted the *Norman* court's error into its foreclosure statute. Hawaii Rev. Stat. § 651-49 (1976). See Carlson, supra note 19, at 567.

23 See U.C.C. § 9-504(4) & comment 4.

24 The difference in foreclosure theory between the two types of senior liens is articulated infra note 38.

25 G. Gilmore & C. Black, The Law of Admiralty § 9-85, at 786–90 (2d ed. 1975). The authors state:

> Only the admiralty court acting *in rem* has the power to divest liens by a judicial sale. Here we touch the central point of our system of admiralty law. Here we should expect to find the winds of litigation at their most turbulent. But, just as at the eye of the hurricane the air is undisturbed, so here the law exists as in a vacuum, its purity undefiled by controversy and dispute. There are no cases—or almost none. There have never been any cases. Presumably there will never be any cases. There is only doctrine.
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> Any maritime lienor may have the ship arrested by filing a libel *in rem* in any district in which the ship is found. . . . If the ship is not released on a stipulation for value and if a judgment in favor of the original or any intervening libellant becomes final, the ship will be sold on order of the court. . . . On sale, all liens

tigate the state of title at such sales. Thus, the "real" price of the collateral is lowered.[26]

Other regimes are not quite as perfect as in rem admiralty sales, but nevertheless achieve higher bids than regimes where fewer priority interests are foreclosed. That is, the more interests foreclosed, the better the title that can be offered. In New York, for example, a sheriff's sale of real estate destroys not only junior judicial liens but senior judicial liens as well.[27] Senior mortgages and some junior mortgages are not foreclosed, however,[28] so that, where a mortgage is recorded, the buyer at the sale will discount his bid by the value of outstanding encumbrances. Because senior judicial liens are foreclosed, buyers should pay more for auctioned land than they would if senior judicial liens could not be foreclosed.

Whatever level of foreclosure is chosen, the foreclosed parties should be granted a priority to the cash proceeds to the sale. Those who are not foreclosed should not be granted a priority to the cash. While these principles are good policy, occasionally they are not followed, with unfortunate effects: junior creditors lose their interests in the collateral without compensation, and senior creditors retain their liens and get a "double" recovery because they are entitled to cash.[29]

> attach to the proceeds of sale. The court will distribute the fund to all maritime lien claimants in accordance with their respective priorities.

Id. at 786–88 (footnotes omitted); see generally American Bank of Wage Claims v. Registry of Dist. Ct. of Guam, 431 F.2d 1215 (1970) (lienholders' claims were destroyed because distribution of proceeds from sale divested in rem jurisdiction).

26 By "real price" I mean the price charged by the seller, plus the cost to the buyer of making the purchase. Title searches are obviously a cost to the buyer and will be important in determining whether to make the purchase.

27 N.Y. Civ. Prac. Law § 5203(a)(3) (McKinney 1978). The proceeds of the sale are distributed, in the order of judgment priority, to those judgment creditors who delivered executions to the sheriff. Id. § 5236(g)(1).

This section explicitly disallows the sale of mortgaged property pursuant to an execution issued on a judgment for recovery of the mortgage debt. Id. § 5236(b). Recovery of such debt must be channeled through N.Y. Real Prop. Acts. §§ 1301–1391 (McKinney 1979 & Supp. 1984–85) (covering judicial enforcement), and id. §§ 1401–1461 (covering public sales). Both chapters on mortgage foreclosure provide for the transfer of whatever title the debtor had at the time the mortgage arose.

The reason that mortgage debt cannot be enforced by a money judgment is to preserve redemption rights for the debtor provided under New York's Real Property Actions and Proceedings Law but not under New York's Civil Practice Law and Rules. 6 J. Weinstein, H. Korn & A. Miller, New York Civil Practice Law and Rules § 5236.02 (1983).

28 The quality of draftsmanship in New York's CPLR is quite disappointing, but the basic intent seems to be what I have indicated in the text. The only mortgages that are foreclosed by execution sale are those created after the judgment lien. Unrecorded "junior" mortgages created before the judgment lien are not foreclosed by an execution sale unless the buyer is a bona fide purchaser for value. A close examination of the language in N.Y. Civ. Prac. Law § 5236 (McKinney 1978) is undertaken infra text accompanying notes 77–81.

29 The UCC is an example of a statute that does not condition rights to the cash proceeds

B. *Priority*

"Priority" is the term that expresses the hierarchy of the right to possess the thing prior to the enforcement sale and the right to possess cash after the sale. Before the sale, the debtor has a right to possess the encumbered item, but this right is subject to the superior right of the lienor.[30] Between lienors, there is also, roughly speaking, a relative presale priority of possession, although statutes often do not make this explicit.[31] After the sale, when foreclosed parties find their property interest transferred from the collateral to the cash proceeds, presale priorities are preserved. After the administrative costs are

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upon foreclosure. Under § 9-504(4), senior secured parties are not foreclosed when the junior secured party enforces his interest. While § 9-504(1) does not list the senior creditor as a party to the distribution, it has been suggested that § 9-306(2) gives the senior creditor a continuing interest in the proceeds of the foreclosure sale. See Consolidated Equip. Sales, Inc. v. First State Bank & Trust Co., 627 P.2d 432, 438 (Okla. 1981); R. Henson, Handbook on Secured Transactions Under the Uniform Commercial Code § 6-1, at 197 (2d ed. 1979); Wechsler, Rights and Remedies of the Secured Party After an Unauthorized Transfer of Collateral: A Proposal for Balancing Competing Claims in Repossession, Resale, Proceeds, and Conversion Cases, 32 Buffalo L. Rev. 373, 398–401 (1983).

If § 9-306 gives the senior party a right to the sale's proceeds, the secured party gets a double recovery—cash and collateral—while the enforcing junior party obtains no cash and loses the collateral. To prevent such severe consequences, the courts should distinguish § 9-504 proceeds from § 9-306 proceeds. In order to preserve meaning to the junior security interest, senior secured parties should have no right to § 9-504 proceeds.

Professor Nickles has a different solution to the problem. He believes that § 9-306 does not give the senior secured party an interest in § 9-504 proceeds. Section 9-306(2) provides that a security interest continues "in any identifiable proceeds including collections received by the debtor." As § 9-504 proceeds are received by the junior secured creditor, they are never "received by the debtor," so that the senior secured party never retains rights in the cash proceeds. See Nickles, Rights and Remedies Between U.C.C. Article 9 Secured Parties with Conflicting Security Interests in Goods, 68 Iowa L. Rev. 217, 245–49 (1983). This argument depends on "received by the debtor" in § 9-306(2) modifying "proceeds" as well as "collections." Id. at 245–46. Since the alternative reading is not very appealing, Professor Nickles' assumption seems acceptable. R. Henson, supra, § 6-1, at 197–98; Frisch, The Priority Secured Party/Subordinate Lien Creditor Conflict: Is "Lien-Two" Out in the Cold?, 33 Buffalo L. Rev. 149, 174–76 (1984).

This argument, however, has a weakness. Since the enforcing creditor can be characterized as the agent of the debtor in selling the debtor's interest and receiving cash in return, courts could easily interpret § 9-504 proceeds as being "received by the debtor" for the purpose of § 9-306. The better solution is to address the problem directly by framing a rule that prevents double recoveries by senior creditors and preserves the ability of junior creditors to realize value from their junior security interests. Frisch, supra, at 177–78.

I have my doubts whether double recoveries should be allowed even under § 9-306—that is, whether a secured party should be able to claim the sales price of the collateral as well as the collateral. But, that is beyond the scope of this project. See generally Taylor Rental Corp. v. J. I. Case Co., 749 F.2d 1526 (11th Cir. 1984) (per curiam) (court allowed undersecured creditor to recover his deficiency at the expense of a buyer who paid fair value for collateral).

[30] Of course, with consensual liens, the creditor may not take possession until default. E.g., U.C.C. § 9-503. Once a judicial lien attaches, the creditor usually has an immediate right to possess (via a court officer). See Carlson & Shupack, supra note 2, at 290 n.9.

[31] See Carlson, supra note 19, at 565–71.

paid, the lienors have the first claim to cash (thereby extinguishing the debts owed them by the amounts received), and the debtor takes any surplus.[32] If the debtor has transferred away his foreclosable rights to a third party, and if those rights are indeed foreclosed, then the third party has the right to any surplus.

Priority is frequently stated as "first in time is first in right,"[33] a formulation that hides far more complications than most lawyers generally perceive. If we assume that liens are not subjected to any perfection requirements against subsequent transfers, a "first in time" rule is consistent with the idea that the debtor cannot convey away the same property twice. That is, once a lien has attached to the debtor's property, the debtor's rights to the property have been reduced to temporary possession (pending the creditor's enforcement)[34] plus the right to receive a cash surplus after the sale[35] and any redemption rights that may exist.[36] If a second lien should attach to the property, it can attach only to what the debtor has remaining: a temporary right to possess, a claim to a cash surplus, and a right to redeem.[37] Each lien creditor can usually sell whatever the debtor had at the time of lien attachment. In the case of the two above liens, the debtor had drastically different property at the two different times of lien attachment. By the time of the second lien, the debtor has much less to convey, as a large portion of his bundle of rights has been conveyed already to the first lienor. These reduced rights (absent expanded foreclosure power) will produce a smaller bid at an execution sale. Thus, a "first in time" priority rule is premised upon the termination of the debtor's property rights at the moment of lien creation.

Legislators can and do alter this vision of lien priority—for example, as when earlier liens are required to be perfected. Essentially, until the lienor perfects, the debtor continues to have the power to convey a valid property interest to a subsequent transferee free of the earlier lien. Where perfection rules exist, priorities are still connected

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32 E.g., U.C.C. § 9-504(1), (2). Section 9-504(1) contains the flaw that junior lien creditors are foreclosed, id. § 9-504(4), without having any claim to cash proceeds according to priorities. See Carlson, supra note 19, at 572–73. Professor Gilmore thought that this failure should be ignored and that lien creditors should be awarded cash according to priority—a proposition that certainly makes sense. 2 G. Gilmore, supra note 7, § 44.8, at 1250.

33 See J. White & R. Summers, Uniform Commercial Code § 25-4, at 1036 (2d ed. 1980). This does not describe all priorities, of course. Maritime liens have a priority by status. Within the status, the rule is often (but not always) "last in time is first in right." See G. Gilmore & C. Black, supra note 25, § 9-62, at 601–02.

34 See J. White & R. Summers, supra note 33, § 23-1, at 902.

35 See, e.g., N.Y. Civ. Prac. Law § 5236(g)(2) (McKinney 1978).

36 See S. Riesenfeld, supra note 9, at 145–54.

37 Kingman Plow Co. v. Knowlton, 143 Iowa 25, 119 N.W. 754, 760–61 (1909).

with termination of liens. But the termination occurs not when the first lien is foreclosed in an enforcement sale. Rather, it occurs when a second perfected lien attaches.[38] Unfortunately, commentators commonly refer to perfection regimes by use of the phrase "first in time,"[39] a terminology that really should be reserved for systems that are unconnected with the subordination of interests that are earlier in time.

Furthermore, legislators can, if they wish, disassociate priority from the termination of the debtor's rights to transfer property. This has commonly been done with regard to liens that attach simultaneously, as we shall soon see.

II. Simultaneous Attachment of Liens

"Attachment" refers to the moment that the lien comes into existence. This idea is most carefully developed in Article 9 of the UCC, where it is defined as a combination of the following events: (a) the debtor and creditor have agreed (usually in writing) that the lien should exist; (b) the creditor has given value; and (c) the debtor has obtained rights in the collateral.[40]

The first of these concepts is simply an affirmation that Article 9 security interests are created solely by contract. Of course, some liens arise by the operation of law—as the result of some step taken to en-

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38 The statement in the text is a compressed version of a rather complicated idea. When a lien is created, a transfer of property from the debtor to the creditor occurs. At the foreclosure sale, both the debtor and the creditor sell immunity from their future claims to the buyer. But when the lien is second in time and senior to the unperfected first lien, the second lienor has received a transfer that is "free and clear" of the first lien. That is, in order to induce the first party to perfect, the debtor has been given the power to convey the same property twice. The second lien, therefore, "terminates" the first lien as soon as it, the second lien, attaches. The first lien is ousted from that portion of the collateral needed to satisfy the senior claim on the debtor's equity.

When the senior second lienor enforces by sale, the buyer takes whatever the debtor had at the time the senior lien attached (the usual foreclosure pattern), plus the buyer takes free of the unperfected first lien. The sale destroys the *senior* lien, but the sale is not needed to destroy the junior first lien. That unperfected lien was already destroyed when the second lien attached, thereby establishing the senior creditor's superior right of sale. For this reason, the buyer at the enforcement sale can take free of the first lien even though he is a bad faith purchaser with regard to it. If the enforcing lienor was junior to the unperfected lien—for example, the second lienor knew of the first lien, and is therefore subordinated to it—the buyer would take free of the unperfected lien only if he were a good faith purchaser. The necessity of the buyer's good faith status at the execution sale is the indicium of whether the unperfected lien has already been terminated.

39 See, e.g., J. White & R. Summers, supra note 33, at 1036 ("first in time" refers to filing date or "some other perfecting act").

40 U.C.C. § 9-203(1). The agreement need not be in writing when the secured party, or his agent, see id. § 9-305 comment 2, is in possession of the collateral.

force a judgment[41] or as the result of performing some service that is endowed by law with lien significance.[42] The attachment rules for such involuntary or nonconsensual liens are not dependent upon any agreement that a lien should exist.

The second concept—creditor's value—simply reflects the truth that liens are property interests that only creditors can own. They "secure" debt—that is, they are property interests designed exclusively to provide a means for extinguishing a debt when the debtor elects not to extinguish the debt voluntarily by tendering payment.[43]

It is the third concept from section 9-203(1) of the UCC upon which we focus here. This is the concept of *qui non habet, ille non dat.*

Where the two other elements of UCC-style attachment have occurred before the debtor has obtained the collateral, a security interest attaches automatically when the property is obtained.[44] At least under the UCC, no further act by the debtor is needed to create the lien. In this regard the UCC is highly progressive. Many courts of the late nineteenth century thought that a debtor's attempt to convey property before he had it was a complete absurdity and a nullity. If the debtor wanted to convey property, he could do so after he obtained it, but not before. This required the debtor to convey his property a second time after he actually acquired it.[45]

Many lien systems besides the UCC have not wasted time with such duplicative requirements. In most states, for example, judgment liens attach to real estate that the debtor acquires after the judgment is docketed. Where liens are created by a creditor's service of a writ of execution on a sheriff, all property that the debtor obtains after service becomes encumbered as soon as the debtor acquires it.[46]

Whenever it is possible to set up a lien that catches debtor property as soon as the debtor acquires it, creditors who have taken the

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41 See S. Riesenfeld, supra note 9, at 102–03 n.4.

42 For example, the mechanic's lien of unpaid contractors, materials suppliers, and workmen on the real estate they improved. See G. Osborne, G. Nelson & D. Whitman, Real Estate Finance Law § 12.4, at 734 (1979).

43 Cf. 11 U.S.C. § 101(28) (1982) (" 'lien' means a charge against or interest in property to secure payment of a debt or performance of an obligation").

44 U.C.C. § 9-203(1), (2).

45 See generally 1 G. Gilmore, supra note 7, at § 2.3 (developing the early cases on conveyance of after-acquired property).

46 Several states do not allow judgment liens to attach to after-acquired property. See Souers, Judgment Liens in Ohio, 16 Ohio St. L.J. 1, 14 (1955). For Pennsylvania law, see Philadelphia Nat'l Bank v. Taylor, 421 Pa. 35, 218 A.2d 246 (1966); General Casmir Pulaski Bldg. & Loan Ass'n v. Provident Trust Co., 338 Pa. 198, 12 A.2d 336 (1940). Connecticut recently repealed its law disallowing judgment liens to attach on after-acquired property. See Conn. Gen. Stat. Ann. § 49-45 (West 1978), repealed by 1983 Conn. Legis. Serv. 1947 (West).

requisite steps will own liens that attach to the collateral at precisely the same moment (when the debtor obtains the property). What follows is an account of the priorities that statutes and court decisions have accorded such simultaneous liens.

A. *The Romulus and Remus Pattern*

A quite common solution is simply to choose one of the simultaneous liens and award it seniority. This solution is then supplemented with a general foreclosure scheme that prevents "senior" liens from being foreclosed by "junior" liens, but which destroys "junior" liens when the "senior" lien is enforced.[47] The simultaneous lien labeled "junior" is then equated with liens that are genuinely second in time.

Article 9 of the UCC generally adopts this solution. For example, where the simultaneous liens are both nonpurchase money security interests, the secured party who first files a financing statement in the appropriate form and location is declared to be senior.[48] This seniority is then supplemented with the power to destroy its "junior" twin.[49]

If neither party has filed a financing statement, Article 9 awards seniority to the first party to perfect by some other means.[50] If neither party has perfected, then Article 9 abandons the Romulus-Remus pattern and allows the security interests to be precisely equal.[51] Actual equality of security interests is unlikely, however. If one of the coeval secured parties enforces his lien, the repossession that usually accompanies enforcement will itself be a perfecting act.[52] But where some third lienor is the enforcing party, simultaneity under Article 9 is at least theoretically possible.[53]

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47 See supra note 29.

48 U.C.C. § 9-312(5).

49 Id. § 9-504(4).

50 Id. § 9-312(5)(a).

51 Id. § 9-312(5)(b).

52 See Raleigh Indus. of Am. v. Tassone, 74 Cal. 3d 692, 141 Cal. Rptr. 641 (1977); Rosner v. Plaza Hotel Assoc., 146 N.J. Super. 447, 370 A.2d 41 (App. Div. 1977). But see Milwaukee Mack Sales v. First Wis. Nat'l Bank, 93 Wis. 2d 589, 287 N.W.2d 708 (1980) (security interest in truck was not perfected upon repossession by seller in Wisconsin where perfection of such security interests is governed exclusively by the motor vehicle laws).

For a discussion of perfection by possession, including repossession, under U.C.C. § 9-305, see J. White & R. Summers, supra note 33, § 23-10, at 933–37.

53 For example, suppose there are three security interests. One is senior by virtue of perfecting. The other two notify the senior secured party that they want to receive proceeds from the sale. See U.C.C. § 9-504(1)(c). The two unperfected secured parties are entitled to equal priority.

Equal lien priorities are also possible where encumbered goods are commingled with each other. See U.C.C. § 9-315; Carlson & Shupack, supra note 17, at 857–64.

The superpriority accorded to purchase money security interests is certainly the most celebrated of Article 9's solutions to the simultaneous lien puzzle. Preliminarily, it must be said that there are two types of purchase money security interests—the retained "conditional sales" interest[54] and the enabling loan security interest.[55] Purchase money security interests retained by the seller are genuinely earlier in time than a competing security interest created by an AAP clause.[56] Such "conditional sales" interests are the remnants of a seller's former ownership rights, and are therefore older in time. In an enabling loan, however, the lender's purchase money security interest attaches to the collateral at precisely the same time as an AAP security interest. The superpriority for this kind of purchase money security interest, then, is based upon choosing priority for one of two simultaneous liens. Although many have tried to reconcile the enabling loan security interest with "first in time" priorities through the fiction of instantaneous seizin,[57] a more satisfactory explanation for the superpriority is that it breaks the monopoly on AAP that the earlier creditor might have, thereby rendering purchase money lenders more competitive in the interest rates they can offer.[58]

The UCC has made an innovation in purchase money priorities. Outside the UCC, purchase money priority can often be had whether or not the purchase money lender perfects his lien.[59] Perfection, it is

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54 U.C.C. § 9-107(a); cf. 11 U.S.C. § 101(48) (1982) (defining "transfer" to include retained security interests).

55 U.C.C. § 9-107(b).

56 A casuistic distinction of no importance may be made here. If the seller retains the security interest and conveys only the rest to the buyer, it can be argued that no simultaneity with a competing AAP security interest arises. (It must be countered, however, that the requirements of attachment, id. § 9-203(1), do not provide for retained security interests). If the sale is absolute and the buyer grants back the security interest to the seller, the purchase money security interest attaches simultaneously with the AAP security interest after all. Which theory applies depends, I suppose, on whether the seller "reserves" or the buyer "grants" in the sales and security agreement. This distinction is meaningless under the UCC, since purchase money security interests are granted a superpriority across the board. The reservation-grant distinction seems to have lingering significance in real estate law, however, formalistic though it may be. See Willard v. First Church of Christ, Scientist, 7 Cal. 3d 473, 102 Cal. Rptr. 739, 498 P.2d 987 (1972) (mostly abrogating this distinction in California with regard to easements).

57 Gilmore, supra note 2, at 1340.

58 See Jackson & Kronman, supra note 11, at 1149–58.

59 See Robinson v. Wright, 90 Colo. 417, 9 P.2d 618 (1932). The *Robinson* court reasoned that the creation of the lien in purchase money mortgages is simultaneous with the transfer of title to the purchaser, but used the "instantaneous seizin" fiction to award priority to the purchase money lender. The court stated that "the title does not for a single moment rest in the purchaser unencumbered by the mortgage." Id. at 421, 9 P.2d at 619. The *Robinson* court applied to security interests in personal property what is a standard rule in real estate finance. A purchase money mortgage in real estate "takes precedence over any other claim or lien

usually said, benefits only subsequent parties. Hence, there is no need to perfect in order to put simultaneous lienors on warning since they have already taken all the necessary lien-creating steps. Nevertheless, Article 9 now requires purchase money lenders to file, although they are sometimes given a grace period after attachment in which to do so.[60]

A Romulus-Remus solution is adopted by Article 9 when one of the twin encumbrances is a judicial lien. In order for a judicial lien to have seniority, it must attach "before" the security interest is perfected.[61] Thus, where the secured party has filed a prelien financing statement, his AAP interest never loses or even ties with a lien creditor's AAP lien. This is an especially important advantage in California and Connecticut, where new statewide "docketing" systems have recently been established for judicial liens on personal property.[62] If the judgment creditor makes such a filing, all AAP of the debtor will immediately succumb to the judicial lien of the judgment creditor.[63] But, thanks to Article 9, such judicial liens on AAP are always junior to secured parties with AAP rights, provided they have filed a financing statement before the debtor acquires the collateral.

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attaching to the property through the vendee-mortgagee," even when the opposing claim predates the purchase money mortgage. G. Osborne, G. Nelson & D. Whitman, supra note 42, § 9.1, at 573–74.

60 Purchase money lenders may preserve their superpriority if they perfect within 10 days of the debtor's receipt of possession. This purchase money security interest is good against lien creditors and noninventory secured parties. U.C.C. §§ 9-301(2), 9-312(4). The purchase money lender is not given a grace period against inventory lenders with AAP rights. U.C.C. § 9-312(3). In fact, an extra perfection step is required to protect the purchase money interest: a letter to the inventory lender before the debtor obtains possession of the inventory. Id. § 9-312(3)(b). The reason for the special treatment accorded to inventory lenders is that they tend to advance new funds on the basis of existing levels of inventory. If there were a grace period, the lender with the AAP interest would be deceived into advancing funds on the basis of encumbered property. See J. White & R. Summers, supra note 33, § 25-5, at 1047–52.

It is, of course, possible to have two purchase money security interests in the same collateral. The prevailing view is that simultaneous purchase money security interests should be governed by § 9-312(5), the residual priority rule that awards victory to the first party to file. See, e.g., Framingham UAW Credit Union v. Dick Russell Pontiac, Inc., 41 Mass. App. Dec. 146 (1969).

61 U.C.C. Section 9-301(1)(b) provides: "[A]n unperfected security interest is subordinate to the rights of . . . (b) a person who becomes a lien creditor before the security interest is perfected . . . ." Id.

62 Cal. Civ. Proc. Code §§ 697.510–.530 (West Supp. 1984); 1984 Conn. Legis. Serv. 359, 363 (West) (repealing 1983 Conn. Legis. Serv. 1947 (West)).

63 Judgment liens for certain types of property may now be obtained by a procedure similar to that of the UCC for perfecting a security interest. Excluded are consumer goods, retail merchandise with a unit value less than $500, negotiable instruments, and registered vehicles or vessels. The procedure may be used alone to establish priority or with other enforcement methods. See Cal. Civ. Proc. Code § 697.530, Legislative Committee Comment-Assembly (West Supp. 1984).

When judicial liens attach simultaneously, courts sometimes designate one as senior. For example, in *Creighton v. Leeds, Palmer & Co.*,[64] the court declared that the first judgment to be docketed should be designated senior and should have the power to foreclose its twin.[65] This solution is similar to the UCC's "first to file" rule, whereby priority can be reserved against all other potential liens in the event that the debtor acquires collateral.

The UCC rule assures the creditor that other creditors will not obtain priority to after-acquired or presently existing collateral. This greater certainty helps to lower the cost of credit. It is harder to make this case for liens pursuant to money judgments because whatever the priorities are, they probably have no effect on the cost of general credit. The initial extension of general credit by definition is made without reference to the reduction in risk that security interests can provide.[66] The general creditor has no right to restrain the alienation of the debtor's property. The general creditor cannot be certain that the debtor will retain the real estate that he held when credit was extended. Neither can the general creditor be sure (i.e., cannot legally compel) that the debtor will obtain real estate in the future or that the creditor will establish the senior lien on such real estate.

Furthermore, the *Creighton* rule cannot be defended as a means of protecting the creditor's investment in debt enforcement itself. If subsequent transferees can obtain the collateral on a senior basis, the would-be judgment creditor has a disincentive to invest in debt enforcement. But federal bankruptcy laws already provide that disincentive. If the debtor (or a competing creditor) files for bankruptcy within ninety days, the judgment lien is a voidable preference if the debtor is insolvent.[67] The disincentives for investment therefore exist at the federal level. There is no use worrying about such matters at the state level.

A competing solution within the Romulus-Remus category was adopted in California in *Hertweck v. Fearon*,[68] where seniority was awarded to the first judgment creditor to serve an execution on the

64 9 Or. 215 (1881).

65 Other states that accord priority to judgment liens on AAP on the basis of the order of docketing are: Maryland, see Messinger v. Eckenrode, 162 Md. 63, 158 A. 357 (1932); Minnesota, see Lowe v. Reierson, 201 Minn. 280, 276 N.W. 224 (1937); and North Carolina, see State *ex rel.* Titman v. Rhyne, 89 N.C. 64, 67 (1883). California also recently enacted this system of priority. See infra note 69.

66 General creditors accept the "risk of debtor misbehavior." If they are less willing to accept that risk, they may decrease it by taking security. See Jackson & Kronman, supra note 11, at 1149–52.

67 11 U.S.C. § 547(b)(3) (1982).

68 180 Cal. 71, 179 P. 190 (1919).

sheriff. In this case the order of docketing was ignored, although docketing would have been decisive in cases not involving the debtor's after-acquired real estate. This policy was said to reward the most diligent creditor.[69]

Although one hears much about the importance of creditor diligence as a factor in lien priorities, I wonder whether it is itself a policy or whether it merely labels the result of "first in time" priorities. As stated earlier, the notion of "first in time" as an organizing principle for lien priorities is a specialized application of the common sense rule that a debtor may generally convey his property only once.[70] If the debtor tries to convey it a second time, the second party obtains nothing. In such a priority system, it is generally true that the first creditor to take steps of lien significance obtains seniority, but it does not necessarily follow that the senior creditor is the most "diligent" or that creditor diligence is a virtue worth protecting.

For example, if two plaintiffs are negligently run over by the debtor's car—one on January 1, and one on the following July 1—the January victim has a built-in advantage for obtaining priority for his judgment lien. But, it does not follow that he wins because he is diligent: he may win even if the July victim is more diligent. Assume that the debtor owns real estate that preexists both judgments. The January victim who obtains a lien on September 1 has been less diligent than the July victim who obtains a lien on September 2. Yet, the January victim still has the senior lien. Diligence is sometimes an explanation for why one party has managed to obtain seniority over another, but it is not the only explanation. Therefore, to abstract out diligence as an explanation for priorities and then to use it to decide an ambiguous case seems to be a questionable enterprise.

The only justification for asserting diligence as an organizing principle for priorities is to preserve the creditor's investment in enforcement. If a creditor could lose to a lien subsequent in time, the creditor would have less incentive to invest in debt enforcement. But, once again, such an argument can hardly be made where voidable preferences are the law of the land. Federal bankruptcy law already provides a strong disincentive to invest in debt enforcement at the

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69 California has recently overruled *Hertweck* by statute. See Cal. Civ. Proc. Code § 697.380(g) 380 (West Supp. 1985). California now accords priority to simultaneous liens on AAP on the basis of docketing.

Other cases that have followed the diligent creditor rule are: Smith v. Lind, 29 Ill. 24 (1862); Elston v. Castor, 101 Ind. 426 (1885); Michaels v. Boyd, 1 Ind. 259 (1848); Burney v. Boyett, 2 Miss. (1 Howard) 39 (1834); Bradley v. Hefferman, 156 Mo. 653, 57 S.W. 763 (1900); Bruce v. Vogel, 38 Mo. 100 (1866); Goetz v. Mott, 21 Abb. N. Cas. 246, 1 N.Y.S. 153 (1888).

70 See supra notes 33–37 and accompanying text.

state level.[71]

B. *The Castor and Pollux Model*

In some states, an execution sale forecloses all judicial liens, whether senior or junior. New York[72] and New Jersey[73] are such states. Where the buyer takes free of all judicial liens, it matters much less whether one of the twin liens is senior.

In such circumstances, New York has opted for equality among twin judicial liens. In *Hulbert v. Hulbert*[74] an execution sale produced cash proceeds, and three AAP liens were subject to a pro rata distribution of the money, even though one of the creditors had docketed and executed first.[75] It is unclear whether the buyer at the execution sale took free of all the equal liens. If not, the lienors would have obtained a double recovery in a sense—money supplied by the buyer and the chance to foreclose against the buyer in the future.[76]

New York's Civil Practice Law and Rules ("CPLR") eliminates this possibility. CPLR section 5236 now provides, although in a rather imprecise way, that outstanding judgment liens die when any

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71 See supra text accompanying note 67.

72 N.Y. Civ. Prac. Law § 5236(e) (McKinney 1978). Where personal property is at issue, the New York statute does not even mention the foreclosure of judicial liens. See id. § 5234. However, all execution creditors receive a right to cash proceeds from the execution sale. This right to proceeds should signify a termination of their liens, in order to avoid a double recovery. See supra text accompanying note 29.

73 N.J. Stat. Ann. § 2A:17-39 (West 1952) (a junior judgment creditor gains priority over a senior judgment creditor by first levying upon the land).

74 216 N.Y. 430, 111 N.E. 70 (1916). See also Belknap v. Green, 56 S.C. 119, 34 S.E. 26 (1899) (lien creditors required to share pro rata with respect to AAP though one creditor had executed first). In New York, *Hulbert* overruled two earlier cases, Adams v. Dyer, 8 Johns. 268 (1811) (per curiam), and Waterman v. Haskin, 11 Johns. 254 (1814). *Adams* and *Waterman* had established the diligent creditor rule followed by several states. See supra note 69.

75 *Hulbert*, 216 N.Y. at 432–33, 111 N.E. at 70–71. The competing judgments must be docketed in the county where the AAP is found. Otherwise, the creditors do not possess a lien on the property and *Hulbert* is inapplicable. N.Y. Civ. Prac. Law § 5203(a) (McKinney 1978).

76 At the time *Hulbert* was decided, the procedure for satisfying money judgments with real property included a right of redemption. See 6 J. Weinstein, H. Korn & A. Miller, supra note 27, ¶ 5236.01, at 52-717 (sale and redemption provisions made up much of §§ 708–755 of the Civil Practice Act of 1920 and much of its predecessor, the Code of Civil Procedure). The debtor was not divested of his title or rights until 15 months after the execution sale. During this period the debtor or his creditor could exercise his right of redemption. If no redemption occurred, the sheriff would execute the proper deed and the buyer was deemed to be vested with title from the time of *sale*. Code of Civ. Proc. §§ 1440, 1471, reprinted in 3 N.Y. Ann. Code 2912, 2925 (Bliss 6th ed. 1913), amended by Civil Practice Act of 1920 §§ 718, 748 (repealed 1962), reprinted in N.Y. Civ. Prac. J-19, -22 (Cahill-Parsons 1946). Thus, New York failed to relate title back to the time of lien creation. See supra note 22. Because this was so, it is impossible to be sure that courts would have viewed the simultaneous liens as foreclosed. Sensible courts, however, always equate the right to cash proceeds from the sale with foreclosure.

one of them is enforced. Ambiguities remain, however. Section 5236(e) provides that any creditor who is "duly notified" of the sale and who fails to serve an execution on the sheriff loses the lien.[77] Presumably, this means that creditors notified by letter and those notified by publication are foreclosed. Creditors who are entitled to a letter, but do not receive one, are presumably not foreclosed by section 5236(e), but section 5236(c) does state that bona fide purchasers take free of a creditor's claim even if the creditor's lien is unforeclosed by section 5236(g).[78] Section 5236(c) does not quite say that the creditor's lien is dead, but it is close enough that courts should read this as the legislative intent.[79]

Regardless of these ambiguities, when things go well, the CPLR wipes out all judicial liens. Simultaneously attached liens have equal priority to the cash, and the buyer takes relatively good title to the real estate.

Although section 5236 does foreclose senior judicial liens, it does not seem to foreclose senior mortgages, and does not even explicitly foreclose junior mortgages. Courts should have no trouble deducing the foreclosure of at least some junior mortgages from the language describing judgment liens on real property.[80] But, no basis seems to

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77 N.Y. Civ. Prac. Law § 5236(e) (McKinney 1978) reads as follows: "A judgment creditor duly notified pursuant to subdivisions (c) or (d) who fails to deliver an execution to the sheriff prior to the sale shall have no further lien on the property and, except as against the judgment debtor, no further interest in the proceeds of the sale."

Nowhere does § 5236 state that judgment creditors who do serve executions also lose their liens, although this gap is filled by § 5203(a)(3)).

78 The relevant portion of N.Y. Civ. Prac. Law § 5236(c) (McKinney 1978) reads: "An omission to give any notice required by this or the following subdivision, or the defacing or removal of a notice posted pursuant to either, does not affect the title of a purchaser without notice of the omission or offense."

79 The problem with N.Y. Civ. Prac. Law § 5236(c) is that it does not make explicit the state of title if the bona fide purchaser conveys in the future to a knowledgeable buyer. But if the lien springs back to life, the title of the bona fide purchaser would be adversely affected—the number of purchasers to whom the bona fide purchaser could resell would be reduced. See generally Carlson, supra note 19, at 559–63 (developing the difference between statutes that terminate liens and statutes that create liens that revive if a bad faith purchaser ever takes the property). In any case, § 5203(a)(3), which contains no bona fide requirements, suggests that the lien is dead.

80 See N.Y. Civ. Prac. Law § 5203(a) (McKinney 1978) ("No transfer of an interest of the judgment debtor in real property, against which property a money judgment may be enforced, is effective against the judgment creditor . . . ."). If junior mortgagees were not foreclosed, the judgment creditor would essentially be junior. For example, assume the land has a value of $1,500. After a judgment lien attaches and before it is foreclosed, the debtor creates a $1,000 mortgage. At the execution sale, buyers would be willing to pay only $500, which is the value of the debtor's equity. If the junior mortgagee had been senior in the first place, the judgment creditor would have realized the same $500. The buyer would deduct $1,000 to account for the unforeclosed "senior mortgage."

The New York CPLR does not address the question of priority in a foreclosure action exist for foreclosing senior mortgages. Likewise, the mortgagee can show no basis for foreclosing senior judgment creditors.[81] This produces a "reverse prisoner's dilemma," a phenomenon that is described in the next section of this Article.

C. *The Reverse Prisoner's Dilemma*

Where an enforcement sale forecloses all liens, the priority between simultaneous liens does not particularly matter to the buyer. But, many courts refuse to allow junior lienors to foreclose senior lienors.[82] Where seniority produces immunity from foreclosure by junior enforcement sales, sequential sales may be necessary. If the junior lien is enforced first, the senior lien is not foreclosed; it can then be enforced in a second sale. In the first sale, the minimum foreclosures take place. Both the debtor and the enforcing junior lienor lose their property interests in exchange for a claim to the cash proceeds from the sale. The buyer then steps into the shoes of the debtor vis-a-vis the senior lienor. When the senior lienor enforces, the new landowner and the lienor once again lose their property in exchange for a claim to the cash proceeds from the sale. The second buyer emerges with title free of both liens and free of claims by the buyer of the debtor's equity. Once again, the foreclosed parties are compensated with cash proceeds from the second sale.

Where the liens have an equal priority, and where courts refuse to hold that one lien can foreclose its equal, a similar solution must be followed. In other words, the first lienor to enforce his rights can sell to a buyer who takes free of the lienor's claim and the debtor's rights. Such a buyer is subject to enforcement of the equal lien, which is not foreclosed. This buyer becomes "the debtor" for the purposes of the

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when a mortgage is created before a judgment lien is docketed, but perfected after the docketing. In Suffolk County Fed. Sav. & Loan Ass'n v. Geiger, 57 Misc. 2d 184, 291 N.Y.S.2d 982 (Sup. Ct. 1968), the court held that the mortgage was superior: "[T]he protection of the recording act can be relied upon only by subsequent purchasers and mortgagees, *not by judgment creditors.*" Id. at 186, 291 N.Y.S.2d at 985.

[81] In a New York mortgage foreclosure action, a judgment creditor junior to the mortgagee must be joined as a defendant. N.Y. Real Prop. Acts. § 1311(3) (McKinney 1979). Thereafter, a sale to a purchaser forecloses the junior judgment creditor. Id. § 1411(2). The statute is silent, however, on whether senior judgment lien creditors can be foreclosed. The silence strongly implies no foreclosure.

[82] See, e.g., Watson v. Strohl, 220 Ind. 672, 686-87, 46 N.E.2d 204, 209 (1943); Weir & Russell Lumber Co. v. Kempf, 234 Iowa 450, 453, 12 N.W.2d 857, 859 (1944); Hult v. Temple, 201 Iowa 663, 668, 208 N.W. 70, 72 (1926); Wright v. Anderson, 62 S.D. 444, 447, 253 N.W. 484, 486 (1934). Article 9 of the UCC also adopts this policy, see U.C.C. § 9-504(4). For a list of states, including authorities, that follow this principle in cases of mortgages, see Note, Divestiture of Liens in Pennsylvania, 89 U. Pa. L. Rev. 373, 378 n.37 (1941).

second sale.[83]

At the second sale, the remaining lienor loses his lien and obtains the senior claim to cash. The buyer at the first sale, now in the shoes of the debtor, loses his interest in the land and obtains a junior right to the cash proceeds of the second sale. The buyer at the second sale emerges with title good against the other players in the drama.[84]

It can be seen that where universal foreclosure is not possible, the

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83 UCC § 9-105(1)(d) defines "debtor" to include the owner of the collateral, even if the owner does not owe the debt to the outstanding lienor.

84 The outcome in Kisterson v. Tate, 94 Iowa 665, 63 N.W. 350 (1895), can be explained through the same analysis. In *Kisterson*, two judgment liens attached simultaneously to the debtor's AAP. The two liens were enforced in sequential sales. Kisterson was the first buyer and Dilehay was the second. Kisterson had sought an injunction to prevent the issuance of a sheriff's deed to Dilehay. The Supreme Court of Iowa refused.

The analysis in the text dictates that when the first buyer (Kisterson) received the first sheriff's deed, he took the land with immunity against the claims of the enforcing lien creditor and the debtor, but not from the simultaneous judgment lien. Thereafter, the outstanding lienor exercised his right to force a second sale. At this sale, the first buyer was in the position that the debtor had formerly been in. The minimum foreclosures of the second sale freed the land of claims by the first buyer (Kisterson) and by the enforcing lienor. Dilehay therefore had good title and Kisterson was accordingly not entitled to an injunction.

The author of a recent student note assumes that *Kisterson* established the principle that simultaneously attaching judgment liens create joint tenancies between the two buyers at the sequential execution sales. Note, The Problem of Judgment Lien Priority and After-Acquired Property in Iowa: Kisterson v. Tate, 69 Iowa L. Rev. 825 (1984). This conclusion is by no means supported by anything in the *Kisterson* court's delphic opinion.

The author of the Note has done some interesting research into the historical record, where he learned that the first and second buyer each sold out to the same third party, who between the two, was bound to have reasonably good title. The author attributes this sale to a decision by the buyers "that they did not want to share title to the land." Id. at 831 n.54. This sale can be explained in a much different way, however. The sale occurred before the supreme court opinion. Both sides viewed their title as questionable. Each sold out to avoid the risk of title failure. The different prices each charged ($317 to the first buyer and $3,529 to the second buyer) can be related to the different risks that each perceived to exist. This hypothesis is more plausible than the author's speculation that the first buyer had some altruistic or "insider" connection with the third party: "Dilehay may have had some interest in the Hephjibah Faith Home Association. That relationship might account for his or his estate's willingness to sell at such a modest price." Id.

Professor Riesenfeld reads *Kisterson* as creating a reverse prisoner's dilemma, which he criticizes as a disincentive for the first creditor to proceed. S. Riesenfeld, supra note 9, at 125. But, he then goes on to suggest that *Kisterson* might be a cotenancy case, as the author of the Iowa Law Review Note suggests. For this proposition, Riesenfeld cites Wood v. Rankin Bros., 119 Iowa 448, 93 N.W. 387 (1903), a case that in no way supports such a view. In *Wood*, several liens existed on the debtor's land, but none of them was simultaneous with another. A senior lien creditor fomented an execution sale that produced a buyer. The junior lien creditor then attempted to start a second execution sale, as was done in *Kisterson*. The *Wood* court held that *Kisterson*, in which the first buyer could not stop the second sale, applied only to simultaneously attaching liens. In *Wood*, the junior lien creditor had been foreclosed in the first execution sale. Since the liens did not attach simultaneously, the opinion in *Wood* lends no weight at all to the proposition that *Kisterson* produced cotenancies in the buyers at separate execution sales.

first of the equal lienors to proceed takes a position vis-a-vis the other lienor that is equivalent to juniority in all respects, including in the amount of money realized on the collateral. For example, assume that the two nonsimultaneous liens are both for $1,000. Unencumbered, the land is worth $1,500 to the highest valuing user. If the enforcing lien were junior, the highest valuing buyer would bid a maximum of $500, because the senior lien of $1,000 would still be outstanding. If the liens are equal, with one lien unable to foreclose the other, and if we follow the theory of minimum foreclosure, the winner of the auction would still bid a maximum of only $500, because the other lien is still outstanding. Thus, where incomplete foreclosure is imposed, equality subordinates the more diligent creditor.

Needless to say, such a solution is unsatisfactory in that it produces a disincentive to proceed—a reverse prisoner's dilemma.[85] Where the collateral is insufficient to satisfy all simultaneous liens, the parties can gain the most by cooperating and splitting the proceeds.[86] Without cooperation, the first lienor to proceed obtains less than the second lienor.

The reverse prisoner's dilemma seems to be the New York system with regard to simultaneous mortgages, or simultaneous liens where one lien is a mortgage and the other is a judgment lien. New York's mortgage foreclosure statutes provide for the foreclosure of only junior liens.[87] New York's CPLR provides only for the subordination of subsequent mortgages.[88] Because neither lien can foreclose a simultaneous rival, the reverse prisoner's dilemma is the unhappy result.

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85 The prisoner's dilemma describes the rewards two individuals can expect in certain situations if they either cooperate or act selfishly. Thus, if two individuals cooperate they receive a fair reward (for instance, three points each). If one individual cooperates and the other defects, the defecting individual receives a high reward (five points), while the cooperating individual receives nothing. If both individuals defect, they each get a nominal payoff (one point). Therefore, a temptation exists to defect and guarantee some kind of reward. This logic, however, holds true for both individuals. In other words, when both parties defect, only a nominal payoff is received (one point), whereas a fair reward could have been received if both parties had cooperated (three points). Hence, the dilemma: each party has an incentive to defect, whereas mutual cooperation leads to higher rewards. See R. Axelrod, The Evolution of Cooperation 206–07 app. B (1984).

86 For cases where all lienors have taken part in the proceedings and been awarded pro rata shares in the sales proceeds, see Ware v. Purdy, 60 N.W. 526 (Iowa 1894), modified and aff'd sub nom. Ware v. Delahaye, 95 Iowa 667, 64 N.W. 640 (1895); Moody v. Harper, 25 Miss. 484 (1853); *In re* Hazard's Estate, 80 N.Y. Sup. Ct. 22, 25 N.Y.S. 928 (1893), aff'd mem., 141 N.Y. 586, 36 N.E. 739 (1894); Summers Hardware Co. v. Jones, 222 N.C. 530, 23 S.E.2d 883 (1943); Moore v. Jordan, 117 N.C. 86, 23 S.E. 259 (1895); Relfe v. McComb, 39 Tenn. 558 (1859).

87 See supra notes 80–81 and accompanying text.

88 Id.

While this solution is not good policy, it is at least consistent with the minimalist theory of foreclosure that was set forth earlier.[89] In the first sale, the enforcing lien and the debtor's interest must disappear. Otherwise, no buyer would ever bid for land. In the second sale, the enforcing lien and the interest of the buyer at the first sale (who stands in the shoes of the debtor) must likewise disappear, on the same principle of minimum foreclosure.

Two other competing solutions have been asserted by courts that refuse to allow one equal lienor to foreclose the other. In both of these solutions, the courts have failed to see that their systems do not achieve the minimally required foreclosures. One criticism of the approaches that follow is that their principles cannot logically be contained to cases of simultaneous liens. The defective reasoning in these cases could just as logically be applied in nonsimultaneous lien cases where two successive sales are needed to foreclose both liens. Since inability to foreclose senior liens is an extremely common feature of enforcement systems, erosion of the minimal foreclosure theory could threaten all debt enforcement mechanisms.

The failure of these solutions to comport with a pure theory of foreclosure is not their most serious problem. As we shall see, each has major practical defects even if the deviation from foreclosure theory is artifically contained to simultaneous lien cases.

D. *The Manichaean Model of Perpetual Conflict*

The first of the competing solutions is to treat simultaneous liens as equal in all respects. Neither can foreclose the other. Rather, they must coexist in perpetual conflict until the parties finally agree to contract out of the legal absurdities. Any type of aggressive action by one party is doomed to be ineffective against the other.

This conclusion was reached by the Supreme Court of North Dakota in *Zink v. James River National Bank*.[90] In that case, two judgments were docketed against the debtor, who later inherited real estate. Each judgment creditor, anticipating the day when the inheritance would become final, organized an enforcement sale. Each sale attracted a buyer willing to pay cash for Zink's future inheritance. Even though two enforcement sales had already occurred, the court ruled that both liens were still alive.[91]

This solution violates the minimum foreclosure theory set forth

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89 See supra text accompanying notes 17–21.

90 58 N.D. 1, 224 N.W. 901 (1929).

91 Id. at 13, 224 N.W. at 906 ("The liens still remain in full force and effect, of equal rank, and the rights of the purchaser acquired at such execution sale are subject to the rights of the

earlier. In the first sale, the enforcing lien should have been destroyed. Otherwise, no buyer would ever have purchased the collateral, even for a price lower than the secured claim of the enforcing lienor. On a similar principle, the enforcing lien should have been foreclosed in the second sale as well. In the numerical example developed earlier, where the land had an unencumbered value of $1,500 and each secured claim was for $1,000, the first buyer could not justify deducting $1,000 and paying $500, as could have been done in the reverse prisoner's dilemma model. If the first buyer were to pay $500 to the first lienor, the first buyer would not only be subject to the second lienor's $1,000 claim, but to the first lienor's remaining $500 claim. This is the result, at least, if the *Zink* court is to be taken literally. Where there is insufficient collateral to satisfy both liens—priority disputes do not generally arise where the collateral is adequate—the *Zink* solution guarantees that there could never be a first sale to a rational buyer.

If the enforcing liens do not disappear in sequential sales by *equal* lienors, why do they disappear in any other execution sale? Where the collateral is worth less than the secured claim, a system *could* be set up that allows the enforcing lienor to repossess the collateral yet again after the execution sale, continuing the process until the secured claim is finally paid. In such a case, the buyer at the sale would essentially be invited to redeem the property for the amount of the debt,[92] a system that guarantees that property worth less than the secured claim (plus unforeclosed liens) would never be sold. Under such a regime, a secured creditor who takes as collateral an item that is worth less than his lien will have to subordinate his lien by contracting with the buyer at the enforcement sale. Strong incentives to contract out of the existing rules are the hallmark of bad commercial law. Suppletive rules should duplicate what most commercial actors would agree to anyway. A rule that meets such a criterion can then be justified as eliminating a transaction cost, since subordination agreements are costly to negotiate.

E. *The Solomonic Model*

Other cases have assumed that equal priority of simultaneous liens results in buyers at the two execution sales taking a cotenancy in

holder of the other judgment lien."). Professor Riesenfeld suggests that the court in *Zink* may have been dealing with a cotenancy. See S. Riesenfeld, supra note 9, at 125; supra note 84.

92 Cf. U.C.C. § 9-506 (debtor may redeem collateral upon fulfillment of all obligations and expenses before the secured party has disposed of the collateral); 11 U.S.C. § 722 (1982) (debtor may redeem tangible personal property securing a consumer debt by paying the lien holder the amount secured by the lien).

the land. In *Matula v. Lane*,[93] two purchasers emerged, each having bought at one of two sequential execution sales. The court decided that each buyer owned a cotenancy based upon the ratio of the enforcing lienor's claim to the total of all lienors' claims.[94] In *Murphy v. Connolly*,[95] the South Dakota Supreme Court, interpreting two execution sales that had occurred some thirty years before, also concluded that the buyers emerged with proportional cotenancies.

The cotenancy assumption also violates the minimum foreclosure theory, but in a different way. It assumes that the debtor's interest in the collateral is only partially foreclosed at the first sale. Using our previous example, the cotenancy solution assumes that if both judgments in that case were for $1,000, and the land was worth $1,500, then each claimant could sell a cotenancy worth $750 to his respective buyer. At the first sale, the debtor is not completely foreclosed, but continues to hold the unsold cotenancy (encumbered by the outstanding lien). In this sense, the cotenancy solution violates the minimum foreclosure theory.

If the cotenancy theory holds for simultaneously attached liens, why not for all liens? For example, using the above figures, if Lien A is senior to Lien B, then perhaps Lien A can sell a two-thirds cotenancy, leaving the debtor with an encumbered cotenancy worth $500. This solution theoretically guarantees lienors their claims and is consistent with the solution reached in *Matula*. The trouble with this theory is that it assumes that buyers at execution sales pay full market price for auctioned collateral. It puts the risk on senior lienors if they don't. We know that buyers do not often pay market value at such sales, however, and we are not anxious to place the risk of depressed bids in this way on the senior lienor. Therefore, the senior lienor is usually entitled to sell title free and clear of the debtor's interest and of any interest created in the collateral after the lien arose.

Another negative implication of the cotenancy theory is that it is the result of hindsight in cases where the second sale actually took place. In the above coequal lien example, the lienor at the first sale received $750 on a claim of $1,000, leaving the debtor with an encumbered cotenancy. It does not follow that the second sale must take place. For example, perhaps the other judgment lienor has found

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93 22 Tex. Civ. App. 391, 55 S.W. 504 (1900).

94 Id. at 393, 55 S.W. at 508. See also Willis v. Downes, 46 S.W. 920 (Tex. Civ. App. 1898) (lien creditors treated as cotenants in the property). Compare Harrison v. First Nat'l Bank, 224 S.W. 269 (Tex. Civ. App. 1920), modified, 238 S.W. 209 (Tex. Comm'n App. 1922, judgment adopted) (judgment creditors took pro rata in the sale proceeds since partition was impossible).

95 81 S.D. 644, 140 N.W.2d 394 (1966).

other property to satisfy his claim. In such a case, the debtor is allowed to keep a cotenancy even though one of the lienors has a deficiency of $250. In essence, the cotenancy theory removes debtor property from the reach of creditors, as if the property were protected by homestead statutes.

III. Which System is the Best?

We have seen five different solutions to the simultaneous lien problem. The first simply labeled one of the liens senior based upon some principle. Since senior liens could foreclose junior liens in most jurisdictions, buyers at an enforcement sale could be relatively certain of what they were buying. In the second system, all liens were foreclosed. The buyer purchased free of the liens regardless of the priorities between the lienors. In the third system, in which equal liens were unforeclosable, buyers were relatively certain what they were buying, but the first lienor to move forward was arbitrarily punished with the cash equivalent of juniority because he could not cause the foreclosure of his coequal lienors. The last two solutions—perpetual unforeclosability and cotenancy—failed to produce the logically minimum foreclosures, with unfortunate results for either the buyer at an enforcement sale or the enforcing lienor, who, under the cotenancy theory, was unable to reach the cotenancy reserved for the unforeclosed lienor.

Of these solutions, the last three can be rejected for creating unfortunate incentives or bad results. The only two reasonable choices are the award of seniority to one of the parties, or an equal priority with a broad foreclosure power.

A. *Establishing One of the Parties as Senior*

Priority is the raison d'etre of security. If a secured party knows he must share priority with future creditors, much of the reason for security—protection from the debtor's future conveyances—will have disappeared. If security does not lower the risk of lending, then the cost of secured loans will certainly rise in relation to the cost of general credit.[96]

These principles are equally true when a secured party merely has to share his priority. If future simultaneous liens arise to claim a pro rata share of the collateral, the original lender's security is diminished, although at a slower rate than if a superseding lien could

[96] Jackson & Kronman, supra note 11, at 1147–52, 1161–64.

appear.[97]

For that reason, it is sound to award priority to the lender who first files the requisite notice. The lender who is first to file can then be certain that any AAP is his alone. On the other hand, complete bondage to AAP lenders has been justly equated with slavery or monopoly power.[98] The superpriority for purchase money security interests is therefore a helpful supplement to the AAP interest. It allows other lenders to compete for the debtor's business, while it does not erode the security of the AAP lender.[99]

Thus, any time a lender is in a position to lower the cost of credit because he can have security against future conveyances, a "first to file or perfect" rule should override the natural simultaneity of the liens. But, where lenders cannot reflect lower risk in lower credit costs, a "first to file or perfect" rule is much less important. The UCC's award of seniority to secured creditors over judgment lien creditors[100] can be justified because the secured party can pass along his greater security to the debtor by lowering interest rates, whereas the judgment creditor cannot justify lowering the cost of credit. This is so for two reasons.

First, many creditors, such as tort victims, make no decision to invest funds in the debtor at all. Hence, the priority of their liens is completely unrelated to the creditor's *ex ante* perceptions of future costs.

Second, even those judgment creditors who do consciously take an investment risk are, by definition, taking the risk of subsequent debtor misbehavior. Or, to be more precise, the creditor hopes that, in worsening financial times, the debtor will pay the claim voluntarily or can be forced to pay through bankruptcy dividends or by the estab-

97 Cf. Carlson, supra note 11 (developing the adverse effects on price caused by the risk of future pro rata sharing of collateral).

98 A major concern of allowing the secured creditor to encumber AAP is "the social desirability of permitting the debtor to mortgage his future." Hogan, supra note 2, at 822.

A similar objection is that the "secured interest party thereby force[s] the debtor to tie up all of his assets and hence [holds] a monopoly over his credit." King, Policy Decisions and Security Agreements Under the Uniform Commercial Code, 9 Wayne L. Rev. 556, 568 (1963). The same article cites a New York Bar Association report that estimates that once a debtor agrees to secure a debt with AAP, it will be almost impossible to secure additional financing from a different lender for approximately five years. King, supra, at 569 (citing 2 N.Y. Law Revision Comm'n Reports 1034–35, 1462 (1954)). For a defense of floating liens, see Gilmore, The Purchase Money Priority, supra note 2, at 1335–38.

99 The anti-erosion principle depends heavily upon the tracing requirement—that the loan actually be used to acquire the collateral. Where this principle is not taken seriously, purchase money lenders could erode the security of earlier lenders. See Jackson & Kronman, supra note 11, at 1165–66.

100 See supra text accompanying note 31.

lishment of judicial liens on his property. Judicial lien priority is important in that it affects the speed with which the debtor's property can be reserved for the judgment creditor before the debtor makes further conveyances. Ultimately, general creditors might not lend at all without assurance that some reasonably efficient method for obtaining liens exists.[101] But, these fundamental concerns do not affect rules for AAP. The risk that AAP will not occur is subsumed in the general risk of debtor misbehavior. Whatever the assessment of debtor misbehavior risk, a change in the rule for AAP is unlikely to affect it.

B. *Equal Priorities*

Where judicial liens are concerned, equal priorities are an acceptable choice, but equality must always be accompanied by broad foreclosure power, so that all simultaneous liens can be terminated in a single sale. Not only is a single sale cheaper than multiple sales, but the inability to foreclose coeval liens produces the reverse prisoner's dilemma, whereby the first party to proceed is junior. Or, even worse, courts could decide that coeval liens can never be foreclosed, or that buyers at successive sales are cotenants.

The decision that simultaneous liens cannot be foreclosed is obviously an attempt to extend the widely adopted policy against foreclosure of senior liens. In fact, the only provinces where complete foreclosure of senior liens seems possible are those of maritime and federal tax liens.[102]

I have already shown the unfortunate consequences that must follow from a policy against foreclosing coeval liens. But, it is also possible to make a broader policy attack against the nonforeclosability of senior liens.

Two reasons are offered for the rule that senior liens cannot be foreclosed in any enforcement action by junior liens. First, the rule is said to be doctrinally compelled by "first in time" priorities. After the senior lien attaches to the debtor's property, the junior lienor can take only what the debtor has: a foreclosable possessory right to the property and the right to the cash surplus at the senior lienor's enforcement sale.[103] To allow the junior lienor to foreclose the senior lien,

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101 The statement in the text is an enormously complex counterfactual assertion. For invaluable commentary on such contentions, see Kennedy & Michelman, Are Property and Contract Efficient?, 8 Hofstra L. Rev. 711 (1980).

102 For a discussion of maritime liens, see supra note 25 and accompanying text. The foreclosure power of federal tax liens is defined by 26 U.S.C. § 6323 (1982).

103 4 G. Osborne, American Law of Property § 16.190, at 456 (A. Casner ed. 1952).

therefore, invades the senior lienor's "sole and despotic dominion"[104] and grants the junior lienor more than the debtor had.[105]

The second reason is that the senior lienor has an interest in running the sale, so that the sales price can be maximized. A junior lienor cannot be counted on to market the collateral to the satisfaction of the senior lienor.[106]

The first of these reasons may be dismissed as no reason at all. Purity of doctrinal vision may be important in order to prevent subversion of doctrine, but there is certainly a good counter argument available with regard to senior liens. The nature of a lien creditor's right is to force a sale for cash. As long as the lien retains its senior right to cash, it should not matter if the junior lienor is obtaining more than the debtor had—the power to convey free of the senior lien. The junior lienor has an important interest in foreclosing the senior lien: unencumbered land can be sold at a better price than encumbered land. Doctrinal purity should not be allowed to stand in the junior creditor's way.

The second point—the senior lienor's interest in controlling the administration of the sale—is more serious. It has limited relevance, however, when both liens are judicial liens. Judgment creditors may not run the sale themselves; they must act through the sheriff. Since the sheriff or other court officer sells for the junior lienor, there is less of an administrative point to be made on behalf of the senior creditor in that context.[107]

When the senior lien is consensual, a private right of sale may be available,[108] and hence, the claim that the senior lienor has an admin-

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104 2 W. Blackstone, Commentaries *2.

105 General Motors Acceptance Corp. v. Maloney, 46 Misc. 2d 251, 252, 259 N.Y.S.2d 211, 213 (Sup. Ct. 1965).

106 4 G. Osborne, supra note 103, § 16.190, at 456.

107 A judgment creditor in New York has the option of asking for a receiver to sell the property without first exhausting all of his legal remedies. N.Y. Civ. Prac. Law § 5228 (McKinney 1978). A judgment creditor can be accommodated with a joint receiver working for both liens. 6 J. Weinstein, J. Korn & A. Miller, supra note 27, ¶ 5228.23, at 52-484. ("Normally only one receiver will be appointed to manage the property of the judgment debtor. After one judgment creditor has obtained the appointment of a receiver, any other judgment creditor may move . . . to extend the receivership to his judgment.").

108 Although a potential for abuse exists, a private foreclosure sale is appealing because it is inexpensive compared to its judicial foreclosure counterpart. G. Osborne, G. Nelson & D. Whitman, supra note 42, § 7.19.

Courts, however, have traditionally regarded private foreclosure sales with suspicion. Hence, in the United States, foreclosure sales are almost always at public auction, thereby protecting the mortgagor by assuring a fair price. See G. Osborne, supra note 5, § 340. In England, a mortgagor is protected by requiring the private sale to be made "bonafide to a stranger and at a reasonable price." Id. at 732.

Private sales in real estate mortgages may be provided for by statute or by the mortgage istrative interest in running the sale must be addressed. But, once again, the senior lienor only aims to recover cash by which to extinguish the secured claim. If the senior lien is immediately enforceable, the senior lienor's interests are adequately protected whenever the price in the junior sale is large enough to guarantee that the senior lien will be satisfied. Thus, a system in which the junior sale is made contingent on a bid large enough to pay all senior liens would protect senior liens and would allow junior lienors to seek a better price.[109]

The Bankruptcy Code essentially provides such a system. Liens are honored in bankruptcy, if they are not voidable by the trustee. Lien creditors may be forced to participate in reorganization plans, where the collateral is important to the plan.[110] But, assuming that rehabilitation is not relevant, the trustee retains administrative control of the sale whenever he suspects that a debtor surplus exists.[111] The debtor surplus, of course, enriches the bankrupt estate on behalf of the unsecured creditors. Just as senior lienors do not always trust the junior lienor to maximize the sales price enough to pay off the senior lien, the trustee does not trust secured creditors of any sort to maximize the sales price in order to raise a debtor surplus on behalf of unsecured creditors.

In light of these two sources of mistrust, the Bankruptcy Code

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itself. See N.Y. Real Prop. Acts. § 1401 (McKinney 1979) ("A mortgage upon real property . . . containing therein a power to the mortgagee . . . to sell the mortgaged property . . . may be foreclosed" if specific guidelines are followed.). In such cases, notice to interested individuals is a common safeguard. The form and content of the notice, as well as those individuals to be notified, varies from jurisdiction to jurisdiction. See G. Osborne, supra note 5, § 340.

The mortgagor is further protected by the court's willingness to set aside private foreclosure sales if irregularities are found. See G. Osborne, G. Nelson & D. Whitman, supra note 42, § 7.21 (although price inadequacy is rarely sufficient, depending on the impact, difficulties with the time and place of sale and unfair practices, such as "chilling the bid," will reverse a sale).

109 Two recent authors have opposed foreclosure of senior liens in junior sales. Frisch, supra note 29, at 163; Wechsler, supra note 29, at 390–96. Neither addresses the idea that the sale by the junior creditor be made contingent on fully satisfying the senior claim. Professor Frisch claims that the senior creditor can be trusted to maximize the sales price, while the junior creditor cannot be so trusted. Frisch, supra note 29, at 163. This assertion seems wrong. Each secured creditor will try to maximize the sales price only to the point where his secured claim is satisfied. When the junior creditor sells, this incentive could be made to work for the senior creditor. That is, the junior creditor can be trusted to obtain a price large enough to satisfy the senior liens and the junior lien. In addition, the expense of sequential sales will be avoided.

Professor Wechsler makes an elaborate proposal for reform that excludes foreclosure of senior liens. Either the senior creditor must take over administration of the sale or waive his rights in cash proceeds from the junior sale. Professor Wechsler does not address a third alternative: that the senior secured party be forced to accept full cash payment in exchange for foreclosure in the junior sale.

110 11 U.S.C. §§ 362(d), 542(a) (1982).

111 11 U.S.C. §§ 362(d), 363(f) (1982).

reaches a happy compromise. First, if the trustee does not believe that a debtor surplus is available (or if the court finds such a belief unreasonable), the trustee must release the collateral to the secured creditor for enforcement pursuant to nonbankruptcy law (unless the property is needed for a rehabilitation of the debtor).[112] If the trustee believes that there is a surplus to be had, the trustee may administer the sale, but the sale may be completed only if: (a) the sale does not foreclose outstanding liens; or (b) the sales price is high enough to satisfy the secured claims. According to section 363(f) of the Bankruptcy Code:

> The trustee may sell property . . . free and clear of any interest in such property of an entity other than the estate, only if . . . (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of such interest. . . .[113]

This solution could be commonly adopted at the state level. That is, junior parties could be accorded the right to sell free of the senior lien so long as the senior lienor received a senior claim to cash and the price attracted from the bid was sufficient to compensate senior parties in full.

One possible objection to such a plan is that there is no guarantee that the senior encumbrance will be in default. That is, the senior lienor may have no present right to demand cash on an accelerated basis to discharge the debt. Or, the senior lienor may have made a future commitment to lend that he cannot break.[114] If the surplus money from the sale reverts to the debtor, the senior lienor loses rights in the collateral and becomes a general creditor of the debtor.

If mandatory foreclosure of senior liens is provided for, there would also have to be a provision overriding default agreements in senior mortgages, so that senior creditors would always be free to accept cash to reduce the debt. A similar provision already exists in Article 9, where pledgees of collateral are entitled to reduce the secured claim with cash proceeds in their possession.[115] Similarly, bind-

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112 11 U.S.C. § 362(d) (1982).

113 11 U.S.C. § 363(f) (1982).

114 Under the UCC, commitments to lend are "value." U.C.C. § 1-201(44). A binding commitment therefore can give rise to a security interest, where the other necessary elements for the creation of a security interest are present. Id. § 9-203(1). If the commitment is prior to the creation of a judicial lien, or if it is made without knowledge of a preexisting judicial lien, the secured party's security interest is senior to the judicial lien. Id. § 9-301(4). Elsewhere, I have participated in criticisms of giving priority for commitments to lend; they tend to screen out lien creditors and are subject to abuse. Carlson & Shupack, supra note 2, at 358–70.

115 U.C.C. § 9-207(2)(c) ("the secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, shall be applied in reduction of the secured obligation").

ing commitments to lend would have to be automatically dissolved if a creditor enforced a junior lien.[116]

Secured parties may further object, however, on the grounds that such junior foreclosure powers eliminate an opportunity to nurture a profitable relationship with the debtor. For instance, the senior loan agreement may include a very lucrative interest rate. If the senior claim is mandatorily accelerated, the senior lienor loses a chance to earn interest in the future that may not be compensated by other opportunities.

This seems to be an illegitimate objection. First, there is the practical point that the inability to meet and pay the debts secured by the junior claim portends imminent financial disaster that will lead to enforcement by the senior lienor. Second, there is no inherent reason why such opportunities should be preserved at the expense of junior lienors, who have their own interests to assert. Preserving the possibility that the senior lender could collect lucrative interest payments is sufficiently unlikely under the circumstances, that the interest of the junior creditor in foreclosing the senior lien should be favored over the senior creditor's desire to preserve a lucrative opportunity.

Such a legislative solution, however, is not politically likely. To the extent lenders wish to have their property interests unforeclosed by junior liens, they probably have stronger lobbies in state legislatures than the diverse interests who might some day end up with a junior conveyance. Hence, we are probably stuck with incomplete foreclosures. But, it does not follow that the policy against foreclosing senior liens—a policy that lacks overwhelming justification—should also be the rule for simultaneous liens. Courts should therefore equate simultaneous liens with foreclosable liens. In this way, the reverse prisoner's dilemma, or its weaker replacements, can be avoided.

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116 Such rules should be waivable by the debtor and the senior lienor. I only propose suppletive rules that fill in omissions the parties may have left in a loan agreement.